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SUBJECT: CROATIA 2007 INCSR REPORT - PART II: FINANCIAL CRIMES AND
MONEY LAUNDERING

REF: STATE 138204

¶1. Below is post's submission per reftel of part II of the INCSR on money laundering.

¶2. Croatia is a middle income transition economy that is neither a financial center nor a venue of choice for money laundering activities. Tourism and services make up the largest portion of GDP.

Croatian authorities consider that most money laundering is linked to domestic criminal activity, frequently to drugs or to various "economic crimes," such as fraud and tax evasion.

¶3. Croatian authorities are concerned about the use of Croatia's ports and borders for the smuggling of black market goods and are working with, among others, the Export Border Security office to tighten controls and screening. However, Croatia does not represent a sizeable market for smuggled goods and is used primarily as a transit route for goods destined for other countries in the region. Between January and July 2007, Customs seized 54 containers and destroyed the contents of 27 containers. The greatest number of seizures occurred in the ports of Split, Rijeka and Ploce.

¶4. Croatia's banking sector is over 90 percent foreign-owned, with large Italian and Austrian banks dominating the market. There are no offshore financial institutions and there is no evidence of any alternative remittance systems operating in the country.

¶5. Croatia has 15 free zones, 13 of which are in operation. The free zones were designed to attract investment. Companies operating in the zones benefit from lower profit taxes and customs and value-added free import of input materials. These companies are subject to the same regulation and supervision as other businesses in the country. There is no evidence that these zones are used for trade-based money laundering schemes or for terrorist financing.

¶6. Croatia criminalized money laundering in Article 279 of its penal code in 1996. In 1997, Croatia passed its Law on the Prevention of Money Laundering (LPML), requiring banks and non-bank financial institutions to report transactions that exceed approximately USD 30,000, as well as any cash transactions that seem suspicious. Aside from cash, the LPML also requires covered entities to report all transactions involving gold, precious metals, and stones, as well as other types of monetary instruments and financial paper. In 2000, Croatia's Parliament strengthened the country's penal code to ensure that all indicted individuals could be charged with the money laundering offense where applicable. Prior to this change, a person could not be charged with money laundering if the predicate offense carried a maximum penalty of fewer than five years in prison.

¶7. Croatia continued the development of its anti-money laundering regime in subsequent years. In 2003, Parliament approved the new Law on the Prevention of Money Laundering (new LPML) that follows the European Union (EU) Directives. The new law also incorporates terrorism financing as well as drug smuggling and trafficking in persons, and requires that all cross-border transactions with cash or monetary instruments exceeding USD 6,500 be reported to Croatia's Financial Intelligence Unit (FIU). The new LPML also expands the

list of entities subject to reporting requirements, including lawyers and notaries. During 2007, the Croatian National Bank drafted guidelines to include anti-money laundering directives as well as a manual for supervision that includes specifics for anti-money laundering.

¶8. Through its regulatory authority, the Ministry of Finance requires financial institutions to use specific software to facilitate compliance with reporting requirements. Cooperation with regulators is generally good, with major financial institutions readily cooperating with Croatian authorities. Financial institutions are required to maintain transaction and customer identification records for a period of five years. Money exchange houses are licensed and operate as outposts of banks, with rates tied to those offered by the banks.

¶9. Croatia's FIU, the Ured za Sprječavanje Pranja Novca (Anti-Money Laundering Department or AMLD), within the Ministry of Finance, has 19 of its possible 22 positions filled. In order to satisfy conditions set in the Anti-Money Laundering Action Plan, a total of 36 positions must be filled by the end of 2007. During 2006, a total of 2741 Suspicious Transaction Reports (STRs) were received. The AMLD opened 281 new analytical cases based on 136 STRs received from the financial sector, 97 from law enforcement and supervisory agencies and 48 based on requests from foreign FIUs. Upon completion of analysis, 87 cases were sent for further investigation and action. During the first 11 months of 2007, 2131 STRs were received and 288 analytical cases were opened, of which 151 were based on financial institution STRs, 100 from law enforcement and supervisory agencies and 37 were based on requests from foreign FIUs. Once analysis was completed for the 2007 cases, 79 of them were forwarded for further action.

¶10. In 2001, the GOC established a National Center for the Prevention of Corruption and Organized Crime (USKOK) within the State Prosecutor's Office. This office has the authority to freeze assets, including securities and real estate, for up to a year. The office also has enhanced powers to seek financial transaction information and to coordinate the investigation of financial crimes. In October 2004, the Parliament revised the law governing USKOK's work. The revisions strengthen the tools USKOK can use to combat organized crime and grant USKOK jurisdiction to investigate narcotics-linked organized crime cases.

¶11. An inter-institutional working group for the prevention of money laundering and terrorist financing began work on March 1, 2007. The working group includes representatives from 11 governmental institutions and agencies involved in the anti-money laundering system (Ministry of Justice, State's Attorneys Office, Ministry of Interior, five offices from Ministry of Finance, Croatian Financial Services Supervisory agency, Croatian National Bank and Security Intelligence Agency). Their objectives include defining and working through weaknesses and risks at the prevention level as well as removing obstacles that deter from effective prevention. The Croatian Financial Services Supervisory Agency and Croatian National Bank have also established joint committees for coordinating money laundering related issues and members of those committees are also a part of the Croatian MONEYVAL delegation.

¶12. Croatia has a history of strict separation of operations in justice and law enforcement. Responsibility for investigating financial crimes remains divided between the police, prosecutor's office, and the ministry of finance. The AMLD investigates suspected money laundering, but does not have law enforcement authority. Cases that show likely criminal activity are forwarded to the national police, who then open a new, criminal investigation of the charges. This division of responsibility is partially responsible for slowing criminal proceedings, as investigative work is duplicated and the police lack the analytical capacity to thoroughly investigate complex financial transactions.

¶13. There have been relatively few actual convictions for money laundering in Croatia - 13 persons have been convicted for money laundering since 1997. Of the 13, eight were incarcerated for money laundering crimes valued at approximately 845,000 HRK (\$169,000) in 2007. The AMLD attributes this apparent increase in money laundering convictions to the "Prevention of and combat against money-laundering" CARDS program that started in 2006. However,

despite improved inter-ministerial cooperation, significant shortcomings persist, including continued weak interagency cooperation, inadequate technical skills of the police and prosecutors when analyzing and dealing with complex financial crimes and a general lack of knowledge among members of the banking community as to what exactly constitutes a money laundering offense. Although the judicial backlog has been cut from 1.4 million cases to one million, understaffing, exceedingly long court proceedings and severe resource constraints hamper the effective prosecution of criminal cases.

¶14. Although Croatian investigators have the authority to temporarily seize property in the course of an investigation, asset seizure legislation needs strengthening in cases of money laundering. Croatian legislation provides that, with regard to asset seizure, the burden falls on the state to prove that the property of a criminal was purchased with illegal proceeds. There is no civil asset forfeiture provision in Croatian law. Therefore, it is extremely difficult to seize assets absent a direct link between a specific crime and its proceeds. The only exception to this is in the case of organized crime, where a 2006 amendment to the criminal code allows for the seizure of property of individuals connected to organized crime groups without establishing a specific relationship between the property and the crime.

¶15. Croatia's legal framework to address terrorist financing is more robust than for money laundering. In 2003 Croatia UN Convention Against Corruption and the International Convention for the Suppression of the Financing of Terrorism in its national law and the state administration has set up procedures their implementation. An inter-ministerial working group meets regularly to share information on terrorism financing, including the circulation throughout its financial system of all international lists of designated individuals and entities. Authorities have the right to identify and, with a court order, to freeze and seize terrorist finance assets. Law enforcement authorities are able to move quickly to seek the required court order to freeze suspect accounts and assets of those individuals or organizations named by the UNSCR 1267 Sanctions Committee. In contrast to other crimes, Croatian law enforcement officials have greater authority to freeze assets linked to individuals and entities included in UNSCRs 1267, 1333, and 1390.

¶16. The AMLD can freeze assets on its own administrative authority for 72 hours. However, obtaining an extension of the initial 72-hour period is more complicated, with the Prosecutor's Office requiring either an international instrument or a formal legal request for an asset freeze. However, according to an AMLD representative, every request to extend an asset freeze has been granted per court order and remained in effect throughout the end of proceedings. In 2006, Croatian authorities froze the dormant accounts of two individuals connected to terrorist groups active in neighboring Bosnia and Herzegovina in the 1990s, in addition to 3 other account freeze orders. The AMLD ordered 4 asset freezes during the first three quarters of 2007.

¶17. In the international arena, the AMLD cooperates fully with foreign FIUs. Croatia does not have limitations on exchanging information with international law enforcement on money laundering investigations. Croatia actively cooperates with its Balkan neighbors in the law enforcement arena, especially in the fight against money laundering, where Croatia worked to establish a regional working group to address the issue. Croatia signed bilateral agreements with Georgian, Ukrainian and Moldovan FIU counterparts in 2007 and is also party to a number of bilateral agreements on law enforcement cooperation with its neighbors, as well as the Southeastern Europe Cooperative Initiative's Agreement to Prevent and Combat Trans-border Crime.

¶18. In addition, Croatia is working in concert with Bosnia and Herzegovina to stem cross-border money laundering and smuggling. The joint efforts include the participation by authorities from both countries as well as the use of new technology and computer programs developed specifically for this purpose. With a thousand-mile border between the two countries, and numerous loopholes caused by the jurisdictional irregularities throughout Bosnia and Herzegovina, this is one of Croatia's most important projects.

¶19. In December 2004, Croatia joined 11 other regional prosecutors

in signing a memorandum of understanding to work jointly to fight organized crime. Croatia also participates as a member in the EU's Community Assistance for Reconstruction, Development, and Assistance (CARDS) Program, which seeks to assist countries of the Western Balkans to achieve a greater level of EU integration. As part of the CARDS Program, in 2005 Croatia signed multilateral memorandum of understanding among the FIUs of Albania, Bosnia and Herzegovina, Serbia, Montenegro, and Macedonia. In 2006, the "Prevention of and combat against money-laundering" program began with Austrian twinning partners.

¶20. Croatia has also intensified its cooperation with Austria, Germany, Italy, and Slovenia regarding border control and crime. As a member of the Council of Europe's Select Committee of Experts (MONEYVAL), Croatia has participated in mutual evaluations with the other members, both by being evaluated, and by sending experts to evaluate the progress of other member states. Regionally, Croatia has assisted and supported the creation of anti-money laundering legislation and the establishment of FIUs in Albania, Macedonia, Serbia, and Bosnia and Herzegovina. Croatia is also an active member of the Egmont Group and sponsored the membership of Albania, Macedonia and Bosnia and Herzegovina.

¶21. The 1902 extradition treaty between the Kingdom of Serbia and the United States remains in force and applies to present-day extradition between Croatia and the United States. However, according to the Croatian Constitution, citizens of Croatia may not be extradited, except to The Hague for the War Crimes Tribunal.

¶22. Croatia is a party to the UN International Convention for the Suppression of the Financing of Terrorism and the UN Convention against Transnational Organized Crime. In April 2005 the GOC ratified the UN Convention against Corruption. Croatia also is a party to the 1988 UN Drug Convention; the Council of Europe Convention on Laundering, Search, Seizure, and Confiscation of the Proceeds from Crime; and the Convention on Transnational Organized Crime. In June 2003, Croatia signed the European Convention on the Transfer of Proceedings in Criminal Matters.

¶23. Although the Government of Croatia has the mechanisms in place to combat money laundering, efforts are hampered by an inability to recruit and retain highly skilled staff for its FIU, a lack of expertise in financial crimes among the police and judiciary and an overly burdensome asset forfeiture regime, problems to which the low number of convictions for money laundering bear witness. With its EU accession process underway, Croatia is under greater scrutiny of its ability to successfully combat money laundering. The current "twinning" project with the Austrian FIU is intended to boost capacity, but Croatia will need ongoing assistance until the various parts of its system can begin to work together to produce results.

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